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Financial resources and mechanisms for sustainable development:
overview of current issues and developments

Report of the Secretary-General

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INTRODUCTION

1. The present report describes progress made in the implementation of chapter 33, "Financial resources and mechanisms", of Agenda 21, ^{1/} which was adopted by the United Nations Conference on Environment and Development (UNCED) in June 1992; the report also provides a number of recommendations for action. The report was prepared by the Department of Policy Coordination and Sustainable Development of the United Nations Secretariat, as task manager for chapter 33 of Agenda 21, in accordance with arrangements made by the Inter-Agency Committee on Sustainable Development (IACSD) at its sixth session. The report is the result of consultations and information exchange among designated focal points in United Nations agencies, government officials, and a number of other institutions and individuals.
2. The analysis of issues and the presentation of policy options contained in the present report are supported by the more detailed discussion contained in the addendum (E/CN.17/1996/4/Add.1).
3. The report and the addendum benefited greatly from preparations for an expert meeting in Manila (see para. 5 below) and inputs from various members of IACSD. Particularly valuable inputs were papers received from the International Monetary Fund (IMF) on economic instruments and the World Bank on the contribution of the private sector to the financing of sustainable development. ^{2/} The Organisation for Economic Cooperation and Development (OECD) made two valuable contributions in the form of a paper on the use of economic instruments (the most recent report of its Development Assistance Committee (DAC)), and the preparation of statistics on financial flows. Other extremely useful contributions were made through papers prepared by the Asian Development Bank on economic instruments, the Office of Development Studies of the United Nations Development Programme (UNDP) on innovative financial mechanisms, and the Economic and Social Commission for Western Asia on economic instruments. In addition, the Earth Council made available the preliminary results of its research on subsidies.
4. Various Governments have provided generous financial and logistical support for convening expert meetings on the financing of Agenda 21, as a contribution to the work of the Commission on Sustainable Development.
5. To support the discussion on finance, the Governments of Japan and the Philippines and the Asian Development Bank provided financial and logistical support for the Third Expert Group Meeting on Financial Issues of Agenda 21 (Manila, 6-8 February 1996).
6. The Manila Meeting provided various substantive inputs for the present report in the form of papers prepared by agencies and individual experts; however, the timing of the Meeting did not allow the inclusion of its outcome in the present report.

I. MOBILIZING EXTERNAL FINANCIAL RESOURCES FOR SUSTAINABLE DEVELOPMENT

7. Total net resource flows from OECD countries and international agencies to developing countries reached a record level of \$185 billion in 1994. As has been the case each year since 1991, the increase was due entirely to private investment and lending. Official development assistance (ODA), which had fallen sharply in 1993, recovered by \$3 billion in 1994 to reach a total of \$59 billion. However, as a percentage of gross national product (GNP), the average ODA contributed by DAC members fell to 0.30 per cent, the lowest level since 1973. Moreover, debt forgiveness and emergency aid each imposed record demands of about 10 per cent of total aid flows.

8. A significant number of developing countries have now advanced towards sustained economic growth and are attracting private capital from abroad. Private flows account for some 60 per cent, compared with 35 per cent in 1986. Official development finance (ODF) now accounts for about 40 per cent of total flows, down from nearly 70 per cent in the mid-1980s.

9. This changed situation calls for developing a new approach to the financing of sustainable development in which adjusting aid strategies to current and future requirements would be a crucial element. The issues that would be discussed in such a new approach would be wide-ranging: they would include domestic resource mobilization, aid effectiveness, policies for attracting higher levels of foreign-direct investment (FDI), remaining debt challenges and measures to secure the sustainability of private flows.

II. MOBILIZING NATIONAL FINANCIAL RESOURCES FOR SUSTAINABLE DEVELOPMENT

10. As in other investment decisions of the private sector, risk perception plays a major role in environmental investments; the policy credibility risk is of particular importance. Private firms cannot be sure that Governments will enforce regulations and not arbitrarily change them; in addition they often lack access to information about new technologies, and do not necessarily consider cleaner production by means of a more efficient use of raw materials as a sufficient incentive to invest.

11. Therefore, implementing enabling policies needs to be put high on the agenda in both developed and developing countries: negative incentives in the form of regulations, taxes, charges, tradeable permits and penalties for non-compliance are essential. In addition, a broad range of positive incentives can boost private-sector finance, in particular financial incentives, incentives for creating or changing markets, and incentives for reducing market risk. In addition, institution-building and campaigns for changing consumption and production patterns can play a major role.

12. There is scope for international organizations to stimulate private-sector investment in sustainable development, in particular through projects for creating or changing markets, reducing market risks or financing global benefits, such as the phasing-out of ozone-depleting substances. Promising

initiatives are currently under way in the areas of forests, energy, new and renewable sources of energy, biodiversity and greenhouse gas mitigation.

13. As to evaluating the performance of economic instruments, a number of developed countries have set up study groups to look at ways of moving towards a more environmentally friendly tax system, and it is hoped that other countries will follow their example in order to speed up the process of achieving concrete reform.

14. The ongoing evaluation of the actual performance of economic instruments will play an important role in efforts to widen the use of such instruments; important lessons can be drawn from the evaluation of pollution taxes, natural resources taxation and emission-trading schemes.

15. Fiscal regimes applied to natural resources have a long way to go in discouraging the excessive extraction and harvesting of natural resources and/or mobilizing substantial additional budgetary resources for sustainable development. This has become evident, for example, from the evaluation of economic instruments applied in the areas of forests and mineral resources.

16. The performance of emission-trading programmes in the United States of America has been impressive in reducing the cost to businesses of achieving the air-quality objectives established by regulatory bodies.

17. In view of rising public-sector deficits and debt and the need to achieve a more efficient allocation of scarce economic resources (which will also benefit the environment), Governments are increasingly interested in reviewing existing subsidy schemes. This is reflected, for example, in a request by the environment ministers of the G-7 countries at a meeting in Hamilton in May 1995: the ministers requested that OECD review its policy of reducing subsidies in order to mitigate the environmental impact of certain producing sectors in OECD countries.

18. The fact is that subsidies may generate negative as well as positive economic and environmental effects, and the distributive consequences of removing subsidies also need to be considered: their net effect on economic and environmental welfare is thus an empirical question. Similarly, the net effects of reforming existing subsidy regimes will depend on the context in which such subsidies were established and the specific ways in which they are reduced or abolished.

III. FEASIBILITY OF INNOVATIVE MECHANISMS FOR FINANCING THE PROTECTION OF THE GLOBAL ENVIRONMENT

19. While such mechanisms as international environmental agreements and the Global Environment Facility (GEF) can make a significant contribution to mitigating global environmental problems, recent discussions in the Commission on Sustainable Development and other international forums have discussed establishing additional mechanisms in the form of global taxes and user charges for financing global environmental efforts. It is argued that such innovative mechanisms should be pursued alongside existing efforts to increase ODA as a

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percentage of GNP, replenish GEF in a substantial way and encourage private-sector investment in sustainable development.

20. Advocates of such taxes and charges tend to assume that they would easily become widely accepted by national Governments and have thus chosen to focus on technical details. Unfortunately, this may not be a realistic approach because global taxes and charges, even if technically feasible, may not be readily accepted. There is currently little apparent willingness on the part of many Governments to cede sovereign taxation power to any international body. In addition, global taxes would probably result in enormous wealth transfers, depending on the design of the individual taxes; this factor alone would make the negotiation of global taxes extremely difficult.

21. Since the Commission discussed an internationally agreed tax on air transport (IATT) at its third session, the work undertaken has yielded few new insights into the major issues involved. It is becoming increasingly clear that if IATT were tied to the total ticket sales of airlines, it could not be expected to effectively internalize the cost of pollution because total airline ticket sales are not closely linked to emissions.

22. Air distance travelled, aircraft fuel consumption and average age of airplanes may be more direct proxies for the level of emissions. Ideally, such a tax should be designed to reduce the average age of airline fleets and encourage the adoption of cleaner technologies.

23. Based on the total air distance travelled (passengers and freight) of 270 billion kilometres in 1994 and a per unit tax of US\$ 0.004 per kilometre, about US\$ 1 billion per annum could be raised by IATT.

24. The so-called Tobin tax is an excise tax on foreign-exchange transactions that has attracted much attention lately, and is actually discussed more for its calming effect on speculation in financial markets and its revenue potential than for its relation to the global environment, which is understandable in view of the huge size of that revenue potential: with the daily turnover in foreign-exchange conversion estimated at about US\$ 1.2 trillion, a tax of 0.01 per cent on the value of each transaction would yield some US\$ 30 billion per year.

25. Five criticisms of the economic and environmental justification of the Tobin tax have been made. First, like all taxes it would introduce an efficiency cost. Second, the distributional impact of such a tax would be complex and could not be predicted with certainty. Third, the focus on reducing exchange-rate volatility is tantamount to treating the symptoms of foreign-exchange markets without attending to the political and economic main causes of foreign-exchange volatility, in particular monetary and fiscal policies. Fourth, the tax is not directly linked to the causes of environmental degradation, and its role in addressing environmental problems would therefore be unclear. Finally, although the technical questions of revenue raising and distribution that such a tax would involve have been studied by academic researchers to some extent, national Governments have not yet been sufficiently involved.

IV. FINANCING THE TRANSFER OF ENVIRONMENTALLY SOUND TECHNOLOGIES

26. Financing the transfer of environmentally sound technologies (ESTs) has remained high on the agenda of the Commission, with particular emphasis on improving the conditions for financing ESTs from external financial resources, facilitating access to traditional national financing mechanisms, and promoting innovative mechanisms for the financing of ESTs.

27. To sharpen the focus of the discussion, it will be important to clearly identify to what extent difficulties in financing the transfer of ESTs differ from difficulties encountered in financing other production inputs: the limited access of environmental firms to venture capital and equity financing is a good illustration of such significant differences. The lack of interest of venture capitalists in funding environmental firms may be attributable to the difficulty of assessing the future regulatory environment and of forecasting the growth of the highly segmented ESTs market, as well as to the disappointing performance of the stock prices of environmental firms.

V. MATRIX OF POLICY OPTIONS AND FINANCIAL INSTRUMENTS: DEVELOPING ITS FORMAT AND CONTENT

28. Given the broad scope of mechanisms and instruments that can be applied to providing funding for the implementation of Agenda 21, a matrix could facilitate the work of the Commission. A rudimentary matrix was submitted to the Commission at its third session (see E/CN.17/1995/8) and was considered to be useful; members of the Commission felt, however, that there was a need for further developing the format and content of the matrix. As a result, an expanded, new matrix has been prepared that presents an indicative set of policy options and financial instruments, organized by sector and category of instrument.

VI. RECOMMENDATIONS

29. Based on the previous sections of the present report, the Commission may wish to consider the recommendations and proposals for action described below.

30. In developing a new vision for financing sustainable development, it will be necessary to arrive at a differentiation between countries that goes beyond simple regional categories or broad income categories in order to capture the reality of a changing world.

31. In view of the strong trend away from State-led development and towards market-based economic strategies, the development of a new approach to the financing of sustainable development will have to become part of integrated policy reform efforts.

32. The issue of the impact on sustainable development of subsidies must be further pursued. In view of the insufficient number, scope and conceptual quality of the subsidy evaluations undertaken to date, it will be important to

support the new work programme of OECD in this area and to encourage other institutions as well, including non-governmental organizations, to strengthen their activities in this important area. Such efforts should contribute to (a) developing a clear definition of subsidies, (b) designing suitable indicators for measuring the magnitude of subsidies and (c) improving the impact assessment of subsidies. In addition, research should assist in formulating recommendations on the desirability of an international effort to review subsidies.

33. The Commission may wish to advance the policy dialogue on economic and fiscal instruments through an active exchange of information and review of experiments with a view to removing obstacles to their effective use.

34. At the first session of the Conference of the Parties to the United Nations Framework Convention on Climate Change, which was held in Berlin in 1995, it was decided to undertake a pilot phase for activities implemented jointly; the Parties identified a need to gain experience regarding the practical and conceptual implications of such activities.

35. The role of pilot schemes as a key to furthering progress towards the launching of a system of internationally tradeable carbon dioxide permits was discussed by the Commission at the third session. In the meantime, a preliminary development plan for a pilot global warming emissions trading programme has been prepared under the sponsorship of the Earth Council with the goal of implementing such a programme starting in 1999. The plan has received strong interest from numerous industrial corporations, national Governments, environmental groups and international agencies. The Commission may wish to express its support for the pilot programme.

36. It is important to examine a multitude of traditional and innovative financing mechanisms for improving the financing of ESTs. In addition, future policy-oriented analyses will need to take into consideration the widely differing situations in developing countries and the specific problems of the economies in transition, in particular with regard to such problems as underdeveloped venture capital industries and inefficient equity markets.

37. It is suggested that the format of the matrix of policy options and financial instruments for sustainable development be further refined to include estimates of the magnitude of the incentive and financing effects that would result from applying each policy option and instrument to each sector.

Notes

1/ Report of the United Nations Conference on Environment and Development, Rio de Janeiro, 3-14 June 1992, vol. I, Resolutions Adopted by the Conference (United Nations publication, Sales No. E.93.I.8 and corrigendum), resolution 1, annex II.

2/ The Third Annual World Bank Conference on the theme "Effective financing of environmentally sustainable development" (Washington, D.C., 4-6 October 1995) provided additional valuable inputs.
